June 17, 1994

AN EXPLANATION OF THE LAW GOVERNING ALLOCATION OF FUNDS RECOVERED BY STATE GOVERNMENTS IN MEDICAID RECOVERY LITIGATION

The Florida legislature recently enacted legislation designed to permit the State to sue third parties to recover funds paid out in the form of Medicaid payments to treat illnesses allegedly related to the actions of those third parties or the use of products they make. Similarly, the Attorney General of Mississippi has filed a lawsuit against tobacco product manufacturers seeking to recover Medicaid expenses allegedly incurred by the State because of the use of tobacco products.

Proponents of the Florida and Mississippi actions have portrayed such litigation as a cost-effective means of reimbursing the state's taxpayers for funds spent on Medicaid. However, this superficial argument fails to take account of the laws governing the funding of state Medicaid programs and, most importantly, the allocation of any funds recovered in litigation against third parties. The drafters of the federal Medicaid laws did not contemplate that states would attempt to recover costs through massive product liability litigation conducted by contingency fee lawyers; thus the precise effect of these laws is difficult to predict. Nonetheless, under any plausible reading of the federal Medicaid statutes and regulations, it is clear that states will recover little or nothing through lawsuits of the kind filed in Mississippi or permitted by the Florida bill. This memorandum summarizes the relevant laws governing the funding of state Medicaid programs.

State Medicaid Programs are Heavily Funded by the Federal Government

State Medicaid programs are funded by a combination of state and federal contributions. Every state receives at least 50 percent of its Medicaid funds from the federal government; for some states the "Federal Medical Assistance Percentage" ("FMAP") is much higher. See 42 U.S.C. § 1396d(b) (establishing formula for determining each state's FMAP); 57 Fed. Reg. 57837, 57838 (listing FMAPs for Fiscal Year 1994) (copy attached); 58 Fed. Reg. 66362, 66363 (listing FMAPs for Fiscal Year 1995) (copy attached). In Mississippi, for example, 78.85 percent of the State's 1994 Medicaid funds will be provided by the federal government.

Funds Recovered in Litigation are Allocated Predominantly to the Federal Government

Given the high percentage of state Medicaid funds that comes from federal coffers, it is not surprising that federal law requires any state recovery against a third party to be repaid to the federal government in proportion to the federal contribution to the relevant state. See 42 U.S.C. § 1396b(d)(2)(B); 42 C.F.R. § 433.140(c). Thus, in the case of Mississippi, a total of 78 percent of any funds recovered in third-party litigation would belong to the federal government. The State would be left with only 22 percent

2024687473

Source: https://www.industrydocuments.ucsf.edu/docs/tkjj0000

of its total recovery. However, even that small share quickly shrinks after attorneys fees and costs are paid.

Attorneys' Fees and Costs Consume Much of the State's Remaining Share

Both Mississippi and Florida law permit the use of contingency-fee attorneys to prosecute Medicaid recovery litigation. In some cases the amount of the fee will be established by law (Florida allows a contingency fee of up to 30 percent), and in other states the fee will be established by the market. In any event, the lawyer's fee and costs can be expected to amount to 30-40 percent of the total recovery.

Moreover, the lawyers' contingency fee does not represent the entire cost to the state of maintaining complex Medicaid recovery litigation. The state as class action plaintiff inevitably would incur tremendous internal costs, such as the time of state employees that is required to answer discovery requests and perform other tasks in connection with the litigation, or the value of judicial time and court support staff.

Uncertainty Regarding Allocation of Litigation Costs

The drafters of the federal Medicaid regulations governing the costs of pursuing reimbursement from third parties clearly never contemplated that states would seek to engage in large-scale class action litigation conducted by contingency-fee lawyers. As a result, the application of the regulations governing allocation of litigation costs between the state and federal governments is uncertain. At least four outcomes are plausible:

1. Under the most likely outcome, the federal government pays 50 percent of all of the state's litigation expenditures, including the portion of the recovery representing outside counsel's contingency fee. See 42 C.F.R. 433.140(b). In the case of Mississippi, this scenario would leave the state with approximately five percent of the total recovery (22 percent state share, less one-half of the 33 percent contingency fee, less 50 percent of other litigation expenses (estimated at 1/2 of one percent)).

2. The federal government pays 50 percent of the state's litigation expenses not including the contingency fee expense, leaving the state to bear the entire attorneys' fee out of its share of the recovery. In this case, assuming a 33 percent contingency fee, the state would lose money by embarking on Medicaid recovery litigation, even before any internal state costs are considered.

3. The federal government pays 50 percent of all litigation costs including the contingency fee, and the state obtains an additional 15 percent of the total recovery as an "incentive payment." See 42 C.F.R. § 433.153. This would

2024687474

Source: https://www.industrydocuments.ucsf.edu/docs/tkjj0000

result in a 23.5 percent recovery by the State of Mississippi (15 percent plus the 8.5 percent resulting from scenario no. 1). The incentive payment referred to in the regulations is made by states that obtain a recovery from third-parties to political subdivisions or other states that assist in obtaining the recovery. It is not at all clear that this provision would allow the state to award itself a fifteen percent incentive fee to be paid out of federal funds.

4. The federal government pays 50 percent of the state's litigation expenses not including the contingency fee, and the state obtains the 15 percent "incentive payment." Assuming a 33 percent contingency fee paid out of the state's share, Mississippi would realize approximately four percent of the total recovery (22 percent state share, less 33 percent contingency fee, plus 15 percent incentive payment).

The result under all of these scenarios – and particularly under the most plausible scenario, number 1 – is that the financial benefit to the state is negligible.

2024687475

Source: https://www.industrydocuments.ucsf.edu/docs/tkjj0000